No. 84-95

In the Supreme Court of the United States

OCTOBER TERM, 1984

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

This case raises questions as to the validity of certain aspects of the FCC's end-user access charge plan, which seeks to recover a part of the cost of local telephone company equipment. A large portion of that equipment is used for both intrastate and interstate service, and its cost is "non-traffic-sensitive" (does not vary with extent of use). The Commission has approved a plan pursuant to which most of the portion of these costs that is allocated to the "interstate jurisdiction" will be recovered through a flat access fee payable by all telephone subscribers, whether or not the particular subscriber makes interstate calls.

The questions presented are:

(1) Whether this end user access charge plan is inconsistent with *Smith* v. *Illinois Bell Telephone Co.*, 282 U.S. 133 (1930).

(2) Whether the Commission invaded the authority to set rates for intrastate service reserved to the states by the Communications Act.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-110a) is reported at 737 F.2d 1095. The orders of the FCC are reported at 93 F.C.C. 2d 241, 48 Fed. Reg. 42984 (1983) (order on reconsideration), and 49 Fed. Reg. 7810 (1984) (order on further reconsideration).

JURISDICTION

The judgment of the court of appeals was entered on June 12, 1984. The petition for a writ of certiorari was filed on July 18, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. This case arises from a rulemaking proceeding undertaken by the Federal Communications Commission to determine how local telephone companies should recover

the "interstate" portion of the cost of those facilities that are used both for interstate and intrastate service. Interstate and intrastate telecommunications service customers use the same local exchange facilities to originate and terminate calls. Local calls, of course, use only the local exchange facilities. When a customer places a long-distance call, however, the call passes through the customer's local "loop" to the exchange "switch" of the local carrier. Only then is it routed through the equipment of a long-distance carrier. When the call reaches its destination city, it is again shunted into a local exchange and is routed to the local loop of the party being called. The effect of this arrangement — a product of the technical configuration of the system — is that part of the use, and thus part of the cost, of local telephone company equipment is attributable to interstate calling.

Pursuant to *Smith* v. *Illinois Bell Telephone Co.*, 282 U.S. 133 (1930), the costs associated with local exchange facilities must be apportioned between interstate and intrastate usage; jurisdiction is divided between the FCC and state public utilities commissions to regulate recovery of the respective shares. Pursuant to Section 410(c) of the Communications Act, 47 U.S.C. 410(c), the actual apportionment, known as the "separations process," is carried out by a board composed of state public utility commissioners and FCC commissioners, which prepares a recommended decision for review by the FCC. Once the "separations process" is carried out, the competent authority in each jurisdiction — *i.e.*, the FCC for the interstate share and the appropriate state public utilities commission for the intrastate share —determines how the share of costs subject to its jurisdiction is to be recovered.

A substantial component of the cost of local exchange facilities used for both interstate and intrastate service remains the same regardless of how much the facilities are

used, and indeed, whether or not they are used at all. This fixed cost component is known in the industry as "non-traffic sensitive" (NTS). Individual subscriber loops are responsible for the preponderance of NTS local exchange costs. Under the separations process the share of NTS local exchange costs allocated to interstate service (and thus subject to FCC jurisdiction) is currently approximately 26%. (Thus, about 26% of the cost of each subscriber's local loop could be deemed allocated to the interstate jurisdiction without regard to the subscriber's individual calling habits.)

The American Telephone & Telegraph Company (AT&T) traditionally has recovered most of the NTS local exchange costs subject to FCC jurisdiction through the familiar mechanism of long-distance toll charges: "usage-based charges imposed on the makers of long-distance calls" (Pet. App. 21a). AT&T in turn made appropriate transfer payments to local telephone companies. Under that recovery scheme, long-distance users bore the entire cost of the interstate portion of NTS costs, while telephone subscribers who made no long distance calls paid no part of the portion of the cost of these facilities that had been allocated to the interstate jurisdiction, even though the cost of these facilities did not vary with use.

2. Technological change and the emergence of firms wishing to compete with AT&T in the long-distance telephone service market impelled the FCC, beginning in 1978, to undertake a rulemaking proceeding to reexamine the basic market structure of the interstate telephone service industry (see Pet. App. 23a-25a). The Commission ultimately concluded that an open market structure and free competition in the interstate telecommunications industry would serve the public interest and further the goals of the Communications Act. *MTS & WATS Market Structure*

Inquiry, 81 F.C.C. 2d 177 (1980).[1] Then, in a series of orders generally known collectively as the "*Access Decision*," the Commission prescribed a comprehensive new system of charges to allow recovery of the interstate share of the cost of local exchange facilities. When the system becomes fully effective in 1990, most of the interstate portion of NTS local exchange costs will be recovered directly from telephone subscribers through a flat "access charge." The balance of the interstate NTS local exchange costs and most interstate service-attributable usage-sensitive local plant costs will be recovered by local operating companies from the interstate carriers through charges assessed on a usage basis. The interstate carriers will, in turn, defray these charges through the long-distance toll rates charged to their customers.[2]

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[1]The Commission's rulemaking proceeding was undertaken independently of the government's antitrust action that led to AT&T's divestiture of the local "Bell" operating companies effective January 1, 1984. By the time the Commission reached the issue of compensation for the interstate use of local facilities, however, the divestiture plan had been agreed to. That plan was a major aspect of the new competitive industry structure that the Commission considered in framing its *Access Decision*.

[2]On May 25, 1984, tariffs implementing the first phase of the Commission's plan became effective. Only multi-line business users now pay the end user charge; the Commission contemplates that an end user charge will be assessed to residential and single-line business customers within the next year. Pet. App. 31a-32a. The ultimate size of end user charges will be limited. In order to protect subscribers in areas with high fixed local plant costs, the Commission will permit a higher percentage of NTS costs in such areas to be allocated to the interstate jurisdiction, recovering the extra costs attributable to this "high cost factor" through usage-based charges to be levied on long-distance carriers and to be placed in a universal service fund. 93 F.C.C. 2d at 281-282. The FCC has initiated proceedings to determine the optimal level for end user charges that will further the goals of promoting an open market environment in the telecommunications industry while preserving universal service. As the court of appeals observed (Pet. App. 51a-52a) because the Commission has not determined the proper level of access charges, questions concerning their amount and any effect of their amount are premature.

3. Numerous petitions for review of the Commission's *Access Decision* were filed in the United States Court of Appeals for the District of Columbia Circuit. Many aspects of the Commission's ruling ranging far beyond the matters at issue here were challenged. The court of appeals affirmed the agency action in all but minor respects.

The court of appeals initially rejected petitioner's claim (renewed here) that *Smith* v. *Illinois Bell Telephone Co.* precludes imposition of a flat access charge on all telephone service subscribers. Describing petitioner's reading of *Smith* as "exorbitant" (Pet. App. 39a), the court of appeals explained that *Smith* held only that regulatory authority at the federal or state level must be addressed to the recovery of that share of local plant costs that is attributable to the class of service subject to its jurisdiction — *i.e.*, interstate and intrastate service, respectively. *Smith* requires that the cost of local plant equipment that is used in both intrastate and interstate service be apportioned between the two forms of service, and that this apportionment serve to demarcate federal and state jurisdiction. The fundamental flaw in petitioner's argument was identified by the court of appeals (Pet. App. 37a-38a; emphasis added):

> Petitioners confuse or blend two questions: (1) jurisdiction or authority to recover costs; (2) the manner in which costs are to be recovered. *Smith* dealt with jurisdiction; it held that a portion of the costs of local subscriber plant may be recovered only under the authority of a body with interstate regulatory powers. *The Smith Court did not address the manner in which the federal agency was to perform its task. It did not hold that the FCC must order recovery of costs allocated to its jurisdiction through usage-based charges.*

The court of appeals also rejected petitioner's contention that by imposing a flat rate access charge on all telephone subscribers the Commission had exceeded its jurisdiction

and had invaded the authority, reserved to the states by Section 2(b) of the Communications Act, 47 U.S.C. 152(b), to regulate intrastate telecommunication service (Pet. App. 39a-43a). The court held that the Commission has discretion to authorize recovery of the component of total NTS local plant costs allocated to FCC jurisdiction under *Smith* and 47 U.S.C. 410(c) through a flat user access charge paid by all telephone subscribers. The court observed that even though some subscribers may not make or receive any interstate calls, because the local plant costs defrayed by the access charge are non-usage sensitive, imposition of the charge on such subscribers is reasonable; the cost of local loop access recovered through the charge is not reduced by a subscriber's abstinence from use of the interstate service which the local loop makes available to him. The court noted that unless subscribers who make no interstate calls are simply to escape part of their share of NTS local plant costs, the alternative to use of a flat rate access charge paid by all subscribers would be to revise the separations process so as to make individualized allocations of the cost of local exchange equipment for each subscriber — a procedure that would be "prohibitively complex and inefficient" (Pet. App. 43a n.22). Thus, the court held, the Commission's approval of flat rate access charges does not amount to setting rates for intrastate service.

ARGUMENT

No question that warrants review by this Court is presented by the Commission's decision directing that a flat rate end user charge paid by all telephone subscribers be used to recover the interstate share of nontraffic sensitive costs of local exchange equipment used indivisibly for interstate and intrastate service.

1. a. Petitioner's contention (Pet. 8-16) that *Smith* v. *Illinois Bell Telephone Co.*, 282 U.S. 133 (1930), requires that interstate costs be borne entirely by those who place

interstate calls is wholly unfounded. As the court of appeals observed (Pet. App. 37a-38a), *Smith* addressed only the question whether the costs of the local exchange plant should be apportioned between interstate and intrastate service and jurisdictions; it did not discuss how — or from whom —those costs, once apportioned, are to be recovered. Indeed, petitioner has not identified any language in *Smith* that addresses the latter question and has not pointed to any subsequent authority that reads into *Smith* any directive concerning the recovery of costs allocated to interstate jurisdiction. Rather petitioner simply suggests that "*Smith* by its nature" requires the recovery of interstate jurisdictional costs from those who make interstate calls (Pet. 12). Petitioner appears to concede (Pet. 13, 16) that *Smith* would permit the FCC to impose flat end user charges on subscribers who actually make or receive interstate calls. But it contends that an access charge levied on all telephone subscribers because it is "a precondition to obtaining local service * * * amounts to an increase in intrastate rates" (Pet. 14).

Petitioner's argument is foreclosed by the separations process, which allocates to interstate service a portion of the cost of local exchange facilities capable of being used for both interstate and local calls. Regardless of his own calling habits, one who subscribes to local exchange service thus causes the local company to incur costs that are deemed interstate as a matter of law. Petitioner's challenge, then, is necessarily to the separations process itself — a matter outside the scope of this case.

Petitioner's argument, moreover, rests upon the incorrect assumption that local telephone service and long-distance service are severable and that a class of exclusively local telephone subscribers exists. But this dichotomy ignores the actual physical and technical properties of the telephone system. One who subscribes to local service

automatically secures access to interstate service — *i.e.*, the *capability* of making and receiving interstate calls.[3] A subscriber who chooses not to make interstate calls can still receive such calls. And because of the physical properties of the telephone system, such a subscriber would always be able to make or receive such calls in an emergency or simply because he changed his mind, without prearrangement. Thus it is reasonable to attribute to each subscriber the fixed costs of local plant equipment capable of being used for both interstate and local calls, whether or not the subscriber in fact makes use of interstate service, and to characterize part of this cost as a cost of making interstate service available to each such subscriber. Petitioner's contention that end user access charges are disguised intrastate rate increases accordingly is inaccurate.[4]

b. Petitioner contends (Pet. 14-16) that Section 410(c) of the Communications Act, 47 U.S.C. 410(c), and its legislative history show that Congress expected that the Joint Board created to carry out the apportionment process

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[3]Conversely, as we observed at the outset (page 2), one who wishes to place interstate calls must, because of the design of the system, ordinarily subscribe to local service.

[4]It is true, of course, that a subscriber who refuses to pay his "access" charge would be subject to termination of service, including local service. But that fact does not warrant characterization of the interstate access charge as an intrastate charge. It would be just as reasonable to characterize local exchange tariffs as a charge for interstate service, for payment for local service is a precondition to obtaining interstate service. But neither of these characterizations would be accurate; each is simply a reflection of the physical interconnection of interstate and local service. In fact, local tariffs recover intrastate costs, and the interstate rate (including the flat rate access charge for all subscribers) recovers interstate costs. In any event, even under the regime in effect prior to the *Access Decision*, local subscribers who refused to pay their long-distance bills were subject to termination of service. Thus the termination sanction does not establish that the access charge is a charge for local service.

required by *Smith* "would allocate costs to the interstate jurisdiction to be recovered in a way that would compensate the local system for the interstate system's use of its facilities" (Pet. 15). But petitioner has not suggested that the Commission's *Access Decision* will result in any failure to compensate local operating companies for the use of their facilities in making interstate calls. Nor would any such suggestion be tenable, for the access charge is designed to provide a means of recovering the amounts due to local carriers for interstate use of their facilities as determined in the separations process. The manner in which costs subject the FCC jurisdiction are recovered is a matter within the Commission's jurisdiction. Thus petitioner's argument based on Section 410(c) simply restates its contention that a flat rate access charge that extends to persons who do not make interstate calls is outside the Commission's jurisdiction. Nor does anything in the legislative history cited support petitioner's contention in this case. The legislative history of Section 410(c), like this Court's decision in *Smith*, addresses the apportionment of costs between the interstate and intrastate jurisdiction; it does not address the means by which either share is to be recovered.

c. Petitioner contends (Pet. 17-20) that the end user access charges prescribed by the Commission invade the authority over local rates reserved to the states by Sections 2(b) and 221(b) of the Communications Act, 47 U.S.C. 152(b) and 221(b). But the premise for this argument (by now familiar) is that the flat rate end user charge is effectively a charge for intrastate service because nonpayment will result in suspension of local service. As we have explained above (page 8 & note 4), this analysis based on the reach of sanctions for nonpayment of particular charges is misleading and ultimately indeterminate. Because of the physical properties of the telephone network, payment of local charges could as easily be said to be a precondition to

receiving long distance service. Petitioner's analysis leads to the untenable conclusion that *all charges* in the telephone system are both all interstate and all intrastate. Moreover, as we have explained, those who pay the access charge do in fact receive an important element of interstate service, whether or not they place or receive long distance calls, for they automatically secure access to the interstate system and acquire the capability to place or receive such calls without prearrangement. Because the interstate service share of costs defrayed through the access charge is comprised of nonusage-sensitive plant costs, it is entirely reasonable to regard the access charge as one that recovers costs attributable to interstate service.

In rejecting petitioner's claim that the access charge invades jurisdiction reserved to the states, the court below observed that the courts of appeals have upheld FCC regulation of practices — such as technical conditions upon which home telephones and answering machines may be connected to the telephone system — that necessarily affect both interstate and local service (Pet. App. 40a-42a, citing *North Carolina Utilities Commission* v. *FCC*, 552 F.2d 1036 (4th Cir.), cert. denied, 434 U.S. 874 (1977), and *Computer & Communications Industry Ass'n* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983)). Petitioner seeks to distinguish these earlier cases (Pet. 18-20), arguing that unlike rules for home telephone terminal equipment — which, in the nature of the system, must be uniform for interstate and local service — the interstate and intrastate shares of non-traffic sensitive local plant costs are susceptible to allocation. The allocability of these cost shares is wholly irrelevant here, however.

The flat rate access charge defrays only the interstate share of these costs as determined through the separations process. The Commission has made a permissible threshold

decision that non-usage sensitive local costs within its jurisdiction should generally be recovered by flat charges. The application of the access charge to persons who make no interstate calls — the nub of petitioner's complaint — then results from the superimposition of a divided jurisdictional scheme upon a physically unified telephone system no less than does the need for uniform rules governing equipment that may be connected to that system. As the court of appeals recognized (Pet. App. 42a-43a & n.22), unless the separations process were carried out in a highly burdensome individualized fashion, subscriber by subscriber, exempting persons who place no interstate calls from the access charge would give such persons an unwarranted subsidy. Fixed local plant costs have for many years been allocated pursuant to *Smith* and 47 U.S.C. 410(c) in a non-individualized manner. This history undercuts petitioner's argument, which would effectively require alteration of this practice. Compare Pet. 19-20.

2. Petitioner argues that the Court should grant certiorari because the case is of "critical national importance" (Pet. 17). The Commission recognizes that its decision mandating recovery of the interstate share of subscribers' line costs through flat rate charges imposed directly on end users is a significant change from the past practice. The Commission's decision is, however, entirely consistent with the broad principle that traditionally has informed public utility ratemaking: that rates should be determined on the basis of cost. See *FPC* v. *United Gas Pipe Line Co.*, 386 U.S. 237, 243 (1967); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). The Commission's ruling is also consistent with the corollary principle that costs generally should be recovered from the customer who is responsible for the utility's incurring them. See, *e.g.*, *American Telephone & Telegraph Co.*, 61 F.C.C. 2d 587, 622 (1976), aff'd *sub nom. Aeronautical Radio, Inc.* v. *FCC*, 642 F.2d 1221

(D.C. Cir. 1980), cert. denied, 451 U.S. 920 (1981); *American Telephone & Telegraph Co.*, 64 F.C.C. 2d 1, 54-56 (1977). The Commission's decision rests on policy considerations that were carefully articulated and applied, and which flow directly from the Commission's central statutory mandate to make adequate service available nationwide, to ensure reasonable and nondiscriminatory charges, and to encourage more widespread and effective use of communications technologies. See 47 U.S.C. 151, 201-205, 218, 303(g).

Although cloaked in jurisdictional garb, petitioner's claim presents, in the final analysis, a challenge to the wisdom of the Commission's policy judgments. The critical issues in this case are, as the court of appeals recognized (Pet. App. 109a), matters for exercise of policy judgment. Expertise in such matters resides peculiarly in the political branches of government. *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, No. 82-1005 (June 25, 1984), slip op. 27-28. The Commission has exercised its judgment in this highly complex case in a manner that the court of appeals determined to be reasonable. In light of the character of the issues involved, any further review of the *Access Decision* should be at the hands of Congress. Recognizing the practical impact its decision might have, the Commission directed that it be implemented only after a transition period running through 1990. This transition period ensures that Congress will have an ample opportunity to review the Commission's ruling and to make any changes deemed appropriate by legislation. Congress is fully aware of the Commission's decision and has monitored the issues presented in this matter closely.[5]

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[5]During the 98th Congress, 27 bills and resolutions have been introduced which would address aspects of the Commission's *Access Decision*. See S. 1382, S. 1626, S. 1660, S. 1667, S. 1830, S. 1931, S.J. Res. 151, H.R. 3364, H.R. 3365, H.R. 3440, H.R. 3522, H.R. 3569, H.R. 3602, H.R. 3621, H.R. 3647, H.R. 3671, H.R. 3809, H.R. 4102, H.R.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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4116, H.R. 4130, H.R. Con. Res. 150, H.R. Res. 231 (1st Sess., (1983)); S. Res. 308, S. Res. 353, H.R. Res. 4844, H.R. 6155, H.R. Res. 473 (2d Sess. (1984)). H.R. 4102 has passed the House of Representatives.

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